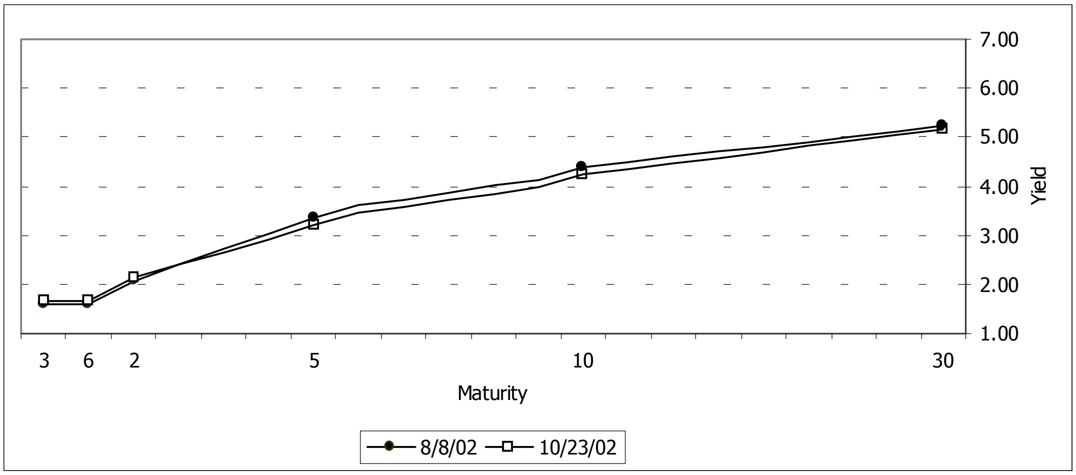
MICHAEL J. MURPHY
State Treasurer

Third Quarter 2002

The QUARTERLY

Local Government Investment Pool

Historical Yield Curve
August 8, 2002 vs. October 23, 2002



LGIP staff

Michael J. Murphy
State Treasurer
(360) 902-9001

Michael Colleran
Assistant Treasurer
(360) 902-9002

Douglas Extine
Deputy Treasurer
(360) 902-9012

Lisa Hennessy
Investment Officer
(360) 902-9013

Jen Thun
LGIP Administrator
1-800-331-3284

Mary Pheasant
Administrative Support
(360) 902-9004

www.wa.gov/tre

Economic recovery continues to falter

If uncertainty ruled the market during the second quarter of 2002, the third quarter showed conclusively that the economy was indeed weak. All the leading economic indicators reaffirmed that the stock market rout, geopolitical worries, sour earnings announcements and corporate defaults were just the right mix for a cocktail of economic weakness and uncertainty. Although interest rates headed to their 41-year low, the economy was still hostage to continuous job losses across different industries. Falling payrolls and rising jobless claims have forced many economists to lower their estimates of 2002 unemployment to between 5.8 percent and 6 percent and of GDP growth to around 2.5 percent from a high of 3 percent. The so-called "engines of growth" — private consumption and investment — have showed signs of strain.

The Federal Open Market Committee (FOMC) during its last meeting (Sept. 24) held rates steady and cited the weakness in the economy and worries about an impending war with Iraq as negative factors that could undermine the country's economic recovery. Fed Governors Gramlich and Mcteer dissented with Fed Chairman Greenspan and called for lower interest rates. Investors pointed out that the dissenting votes could raise the odds of an interest rate ease during the November 6 FOMC meeting if the economic numbers continue to worsen. However, the Fed reiterated its view "(that) the current degree of monetary accommodation is appropriately calibrated to provide stimulus needed to foster a solid (economic) expansion."

However, continuing worries about the stock market decline and the ability of companies to meet

continued on page 2

Market summary

from page 1

their earnings have made investors pessimistic. The August 13 minutes of the FOMC meeting revealed a concern that financial markets were affecting economic recovery. Indeed, investors have seen wealth dissipate by $8.4 trillion from its March 2000 peak and $3.5 trillion since the beginning of the year.

The non-stop destruction of wealth has also affected consumers' sentiment, which declined in October for the fifth straight month to the lowest level in 11 months. The sentiment index fell to 80.4 from a September reading of 86.1, surpassing its November 2001 low of 83.9. There is a real concern that the big reduction in consumers' wealth due to the stock market decline, combined with the unstable job market could prevent consumers from spending during the most important quarter for retailers — Thanksgiving and the run-up to Christmas.

Jobless claims have held above the 400,000 average, which has been viewed by some as the threshold where the economy could start losing jobs faster than its ability to create employment. Companies that have been aggressively cutting jobs in order to meet their earnings target for FY2002, have also been unwilling to invest capital in their businesses, due to the continued overhang of capacity, uncertain business environment, and illiquid corporate bond market.

Investing has been a daily challenge to both small and institutional investors. Yield rates on government bonds have been the lowest in decades. Corporate bonds, which had been the investment of choice to get better yields, also blew up as bad earnings, liability problems, defaults, and bankruptcies pushed investors to buy government bonds for safety. Yields on investment-grade bonds reached 251 bp over treasuries, the highest spread since 1992.

During most of the third quarter the bond market benefited from the sell-off in equities as investors sought the safe haven of bonds. Combined with the current state of the economy and the view of many investors that the Fed could eventually ease rates again before the end of 2002, the bond market experienced a strong rally during the third quarter. This was most pronounced in the intermediate portion of the US Treasury curve. While the three-month, six-month and one-year sectors rallied by 15, 25 and 48 basis points (bp), respectively, during the third quarter, yields in the two-year, five-year, and 10-year sectors decreased by 114, 144, and 118 bp, respectively. The rally in the bond market was a confluence of factors like equity weakness, perceptions of rate ease, the blowout in corporate credit spreads and the Fannie Mae announcement that its portfolio was 14 months shorter than its target duration. The treasury market was the best-performing of the fixed income instruments because of its relative safety. Agency and corporate bond spreads widened due to heightened investor aversion to risk.

No one can blame investors' pessimism as the stock market tortured investors with its huge decline in Q3. The DJIA, S&P500, and the NASDAQ lost an average of 16 percent for the third quarter alone. Corporate earnings weakness and CEO pronouncements of earnings in Q4 not meeting targets were reasons enough for investors to throw in the towel. Many investors were awakened with the realization that equity markets could decline further in this bear market.

The net return on the LGIP during the third quarter of 2002 ranged from 1.79 to 1.72 percent. The targeted Fed Funds rate has now been at 1.75 percent since December 2001. Many investors believe the next move by the Fed will be an ease, possibly as early as Nov. 6. Other investors, while they do not believe a tightening will occur anytime soon, do not believe the Fed will lower the Funds rate below the current level. These views have predominated the short-term market and resulted in an environment that offers few investments that provide positive carry, e.g., a yield above 1.75 percent. Accordingly, the gross LGIP yield will hover around the 1.75 percent area as long as the targeted Fed Funds rate remains at 1.75 percent.

The following article is the first in a new educational series titled "Investing 101," focusing on basic investment issues. The series will include topics such as: Using the LGIP in a Bull Market vs. Bear Market; Managing Average Life; and Gap Analysis. We hope you find these articles informative and helpful. To suggest other topics for the series, call Lisa Hennessy at (360) 902-9013.

Investing 101
The Targeted Federal Funds Rate – A Gauge of LGIP Rates

The Targeted Federal Funds Rate

As the calendar year comes to a close and, for many, budget-preparation time nears, the question often arises, "Where do you expect the LGIP rate to be next year?" Try as we might, we just can't get a clear reading from the trusty crystal ball. While it's impossible to predict where rates will be, the targeted federal funds rate is a good indication of expected LGIP rates.

The targeted federal funds rate, often referred to as the fed funds rate, is the interest rate charged by banks to other banks. The Federal Open Market Committee (FOMC), chaired by Alan Greenspan, sets this rate. The FOMC adjusts the targeted fed funds rate in an effort to stimulate economic growth while holding inflation in check. The FOMC might raise the funds rate (referred to as "tightening") to slow speculative growth and head off inflation. On the other hand, and as we have seen over the last year and a half, the FOMC may lower the funds rate (also known as "easing") in an effort to stimulate the economy.

continued on page 4

Also offered by the Office of the State Treasurer. . .

LOCAL Program

Financing solutions for local government equipment and real estate needs.

www.wa.gov/tre/local.htm

Contacts:

Sue Melvin
Equipment specialist
360-902-9022

Kristi Wolgamot
Real estate specialist
360-902-9020

Pam Johnson
LOCAL specialist
360-902-9021

An update on the Treasury Management System (TM$)

TM$ has been a significant development for the various functional areas in OST, including Debt, Investments, Cash Management, and Treasury Accounting. TM$ has allowed a higher degree of integration between these groups and helped promote efficiency within OST. TM$ has been a great success, coming in on time and under budget and with high marks for performance.

TM$ has also had a big impact on the LGIP, and we trust LGIP participants have found TM$ to be a valuable tool. We're pleased with the rate of use, which is running at around 60 percent. TM$ not only allows participants to make transactions over the Web, but also offers access to reports, account balances and participant information.

Participants may also view their end of month statement the moment earnings have been allocated, making it the quickest way to examine earnings figures and the month's earnings rate.

One enhancement that will soon be available is the ability to access more than one year's account ledger data. For example, participants now can view their account ledger only back to November 2001. Participants soon will be able to view this report farther back in history. We look forward to this and other new advancements planned for TM$.

LGIP Holiday Schedule for 2002 & 2003

The Local Government Investment Pool will be closed on the following days:

2002		
Monday	November 11	Veteran's Day
Thurs/Fri	November 28-29	Thanksgiving
Wednesday	December 25	Christmas Day
2003		
Wednesday	January 1	New Year's Day
Monday	January 20	Martin Luther King's Birthday
Monday	February 17	President's Day
Monday	May 26	Memorial Day
Friday	July 4	Independence Day
Monday	September 1	Labor Day
Monday	October 13	Columbus Day
Tuesday	November 11	Veteran's Day
Thurs/Fri	November 27-28	Thanksgiving
Thursday	December 25	Christmas Day

Investing 101

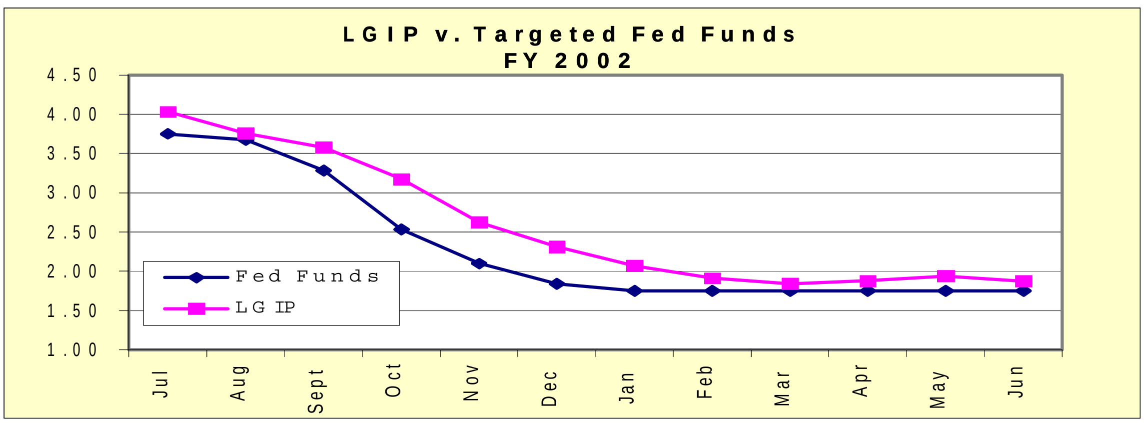
from page 3

What's the connection?

The LGIP is comparable to a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission. This means the LGIP's investments are limited to high-quality obligations with limited maximum and average maturities, which minimizes both market and credit risk. As a result of these restrictions, the LGIP's investments are closely linked to the targeted funds rate. Furthermore, the short maturity structure means the yield of the LGIP will change fairly quickly when the FOMC changes the fed funds rate. However, because the LGIP portfolio generally has an average life of between 30 and 70 days, and the targeted fed funds will change immediately upon the FOMC pronouncement of any change, the LGIP yield will lag changes in the funds rate. Our goal in managing the LGIP portfolio is to lag the targeted fed funds rate as short as possible when rates rise, and as long as possible when rates fall. This is achieved by managing the average life of the LGIP portfolio. (Watch for an upcoming article on "Managing Average Life.") The bottom line is that the LGIP yield will never depart very far from the targeted funds rate.

How has the LGIP performed by comparison?

During fiscal year 2002 the federal funds rate dropped from 3.75 to a 40-year low of 1.75. As expected, the LGIP's yield declined as well. However, as the figure below demonstrates, on a net basis the LGIP consistently outperformed the federal funds rate throughout the fiscal year.



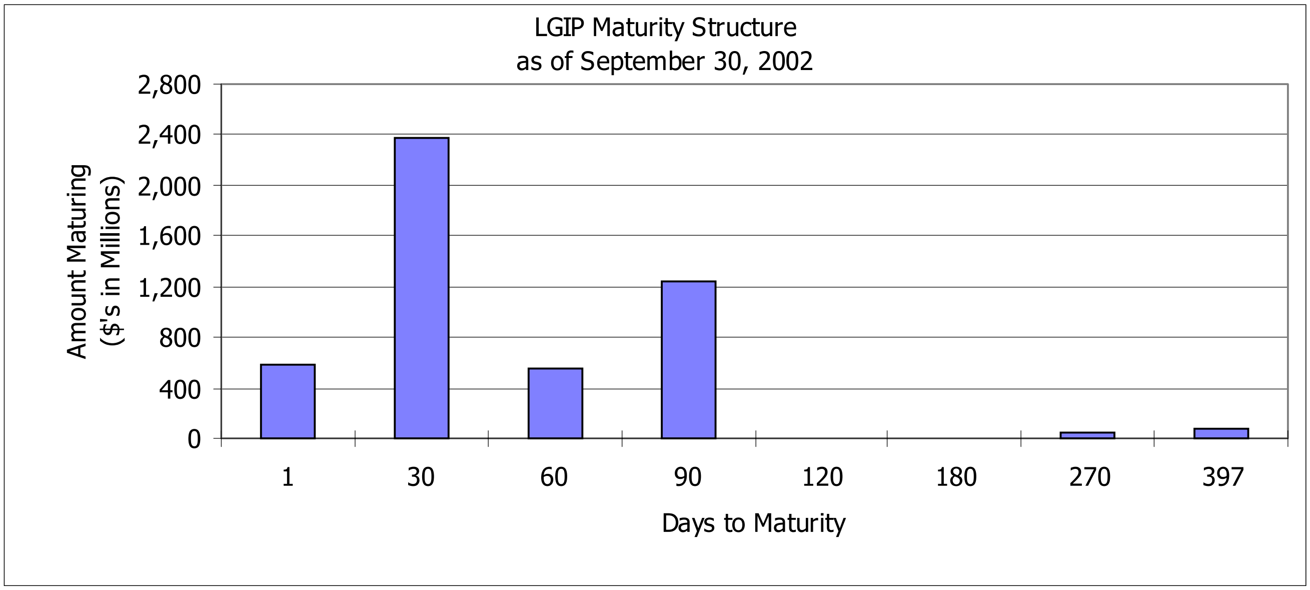
The following table illustrates the LGIP's performance relative to the fed funds rate over several fiscal years:

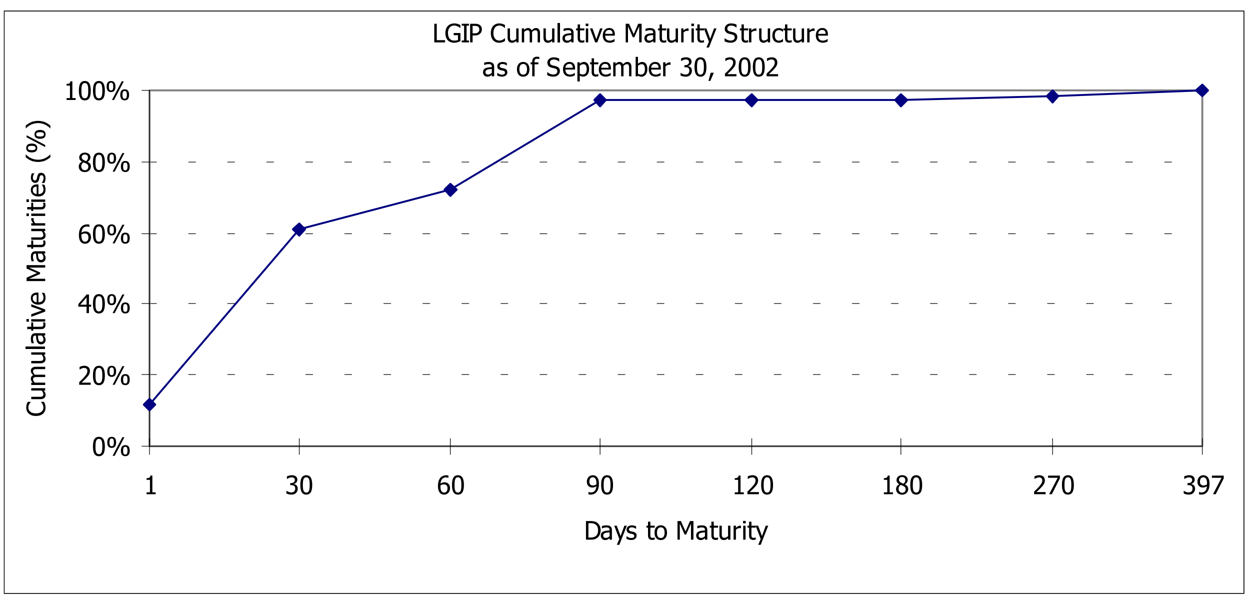
LGIP v. Targeted Fed Funds
Average Monthly Rates FY '98 – '01

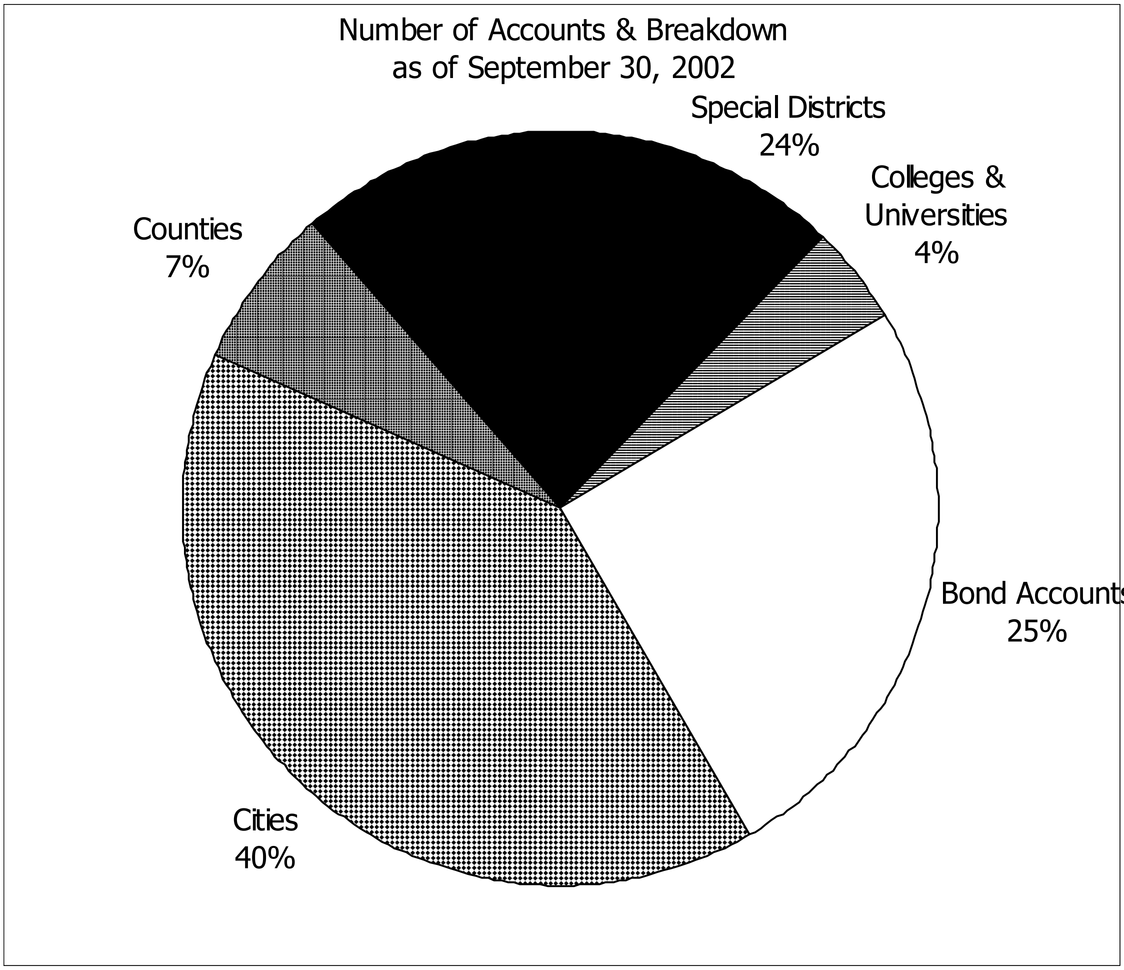
	1998	1999	2000	2001
LGIP Net Rate	5.52%	5.06%	5.56%	5.80%
Targeted Fed Funds Rate	5.50%	4.98%	5.61%	5.74%

Take the pulse of the market

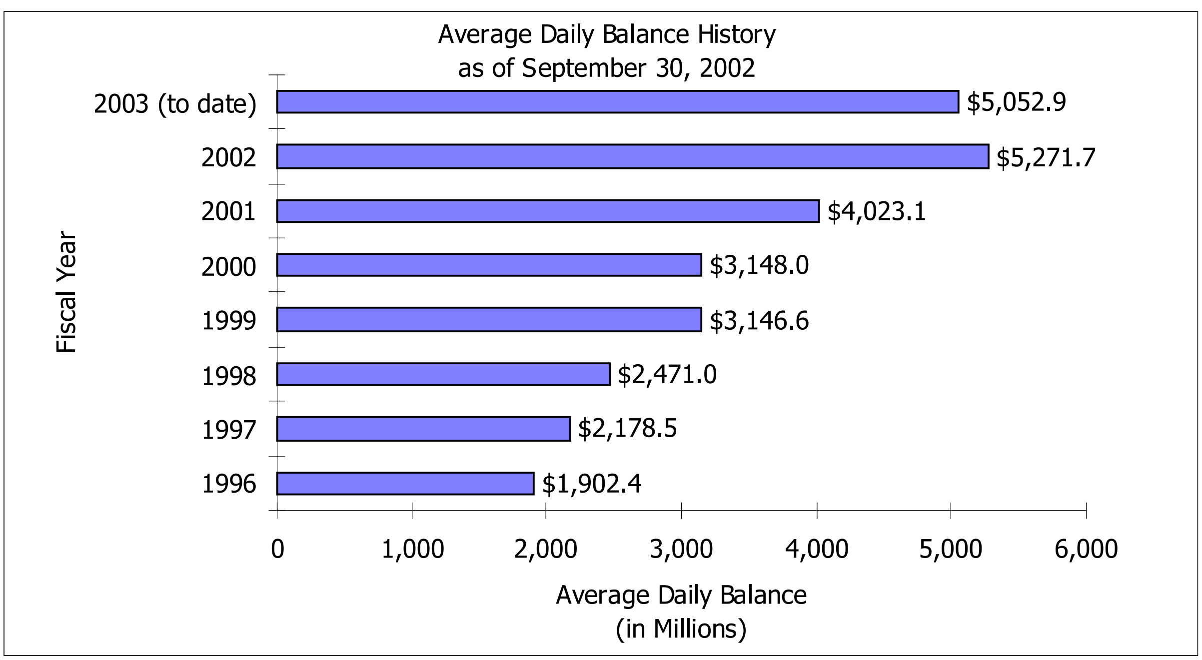
So, as you can see, by keeping an eye on the targeted federal funds rate, and an ear for "fed talk," you'll have a pretty good indication of where the LGIP rate is likely to be. While you won't be able to predict the rate exactly, you'll know the general direction and an approximate range.

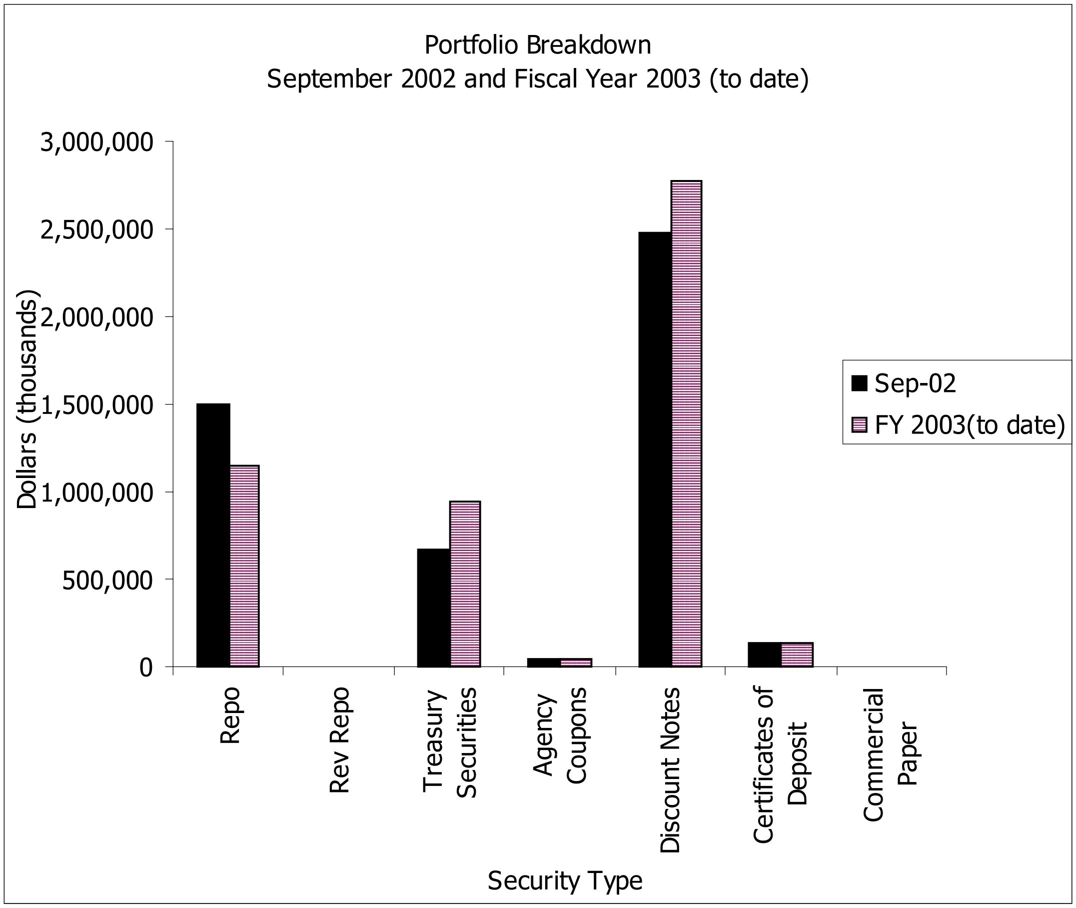

LGIP Maturity Structure
as of September 30, 2002
2,800
2,400
2,000
1,600
1,200
800
400
0
Amount Maturing
($'s in Millions)
1
30
60
90
120
180
270
397
Days to Maturity

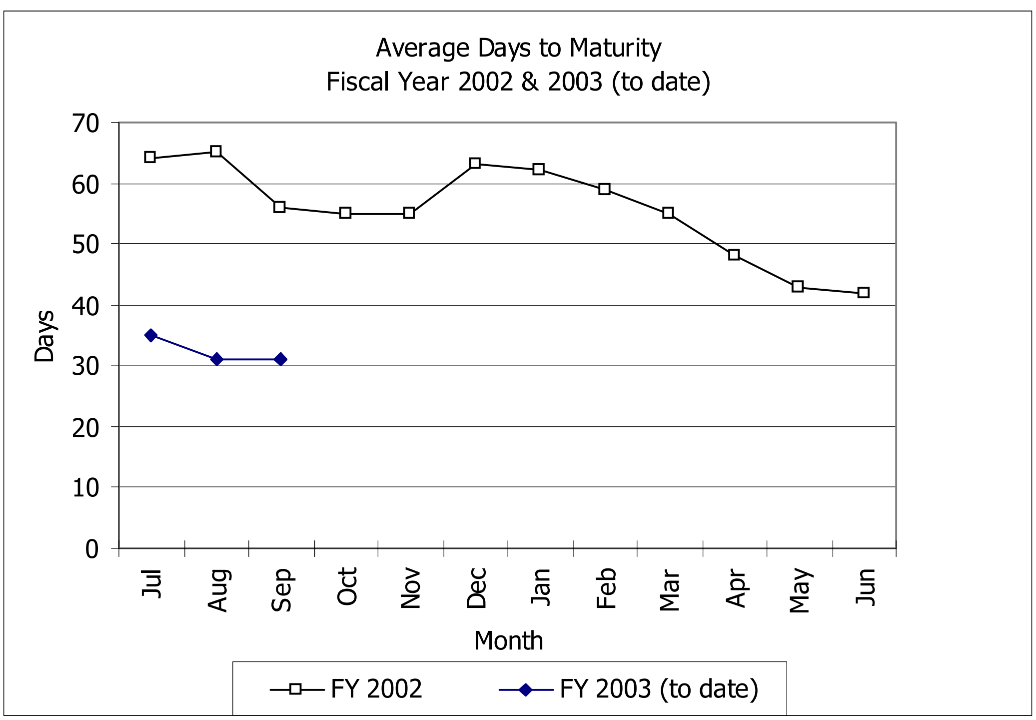

LGIP Cumulative Maturity Structure
as of September 30, 2002
100%
80%
60%
40%
20%
0%
Cumulative Maturities (%)
1
30
60
90
120
180
270
397
Days to Maturity



Total number of accounts: 555




Portfolio Breakdown
September 2002 and Fiscal Year 2003 (to date)
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
Dollars (thousands)
Sep-02
FY 2003(to date)
Repo
Rev Repo
Treasury Securities
Agency Coupons
Discount Notes
Certificates of Deposit
Commercial Paper
Security Type


Average Days to Maturity
Fiscal Year 2002 & 2003 (to date)
70
60
50
40
30
20
10
0
Days
Jul
Aug
Sep
Oct
Nov
Dec
Jan
Feb
Mar
Apr
May
Jun
Month
FY 2002
FY 2003 (to date)

Washington State Local Government Investment Pool
Position and Compliance Report
as of September 30, 2002
(Settlement Date Basis)

LGIP Portfolio Holdings

		Cost	Percentage of Portfolio
Repurchase Agreements	$	1,985,852,000	40.68
U.S. Treasury Securities		175,381,260	3.59
U. S. Agency Bullets		50,646,360	1.04
U.S. Agency Generic Floaters		....	0.00
U.S. Agency Discount Notes		2,539,792,722	52.02
Certificates of Deposit		130,550,000	2.67
Bankers Acceptances		....	0.00
Commercial Paper		....	0.00
Reverse Repos		....	0.00
***Total Excluding Securities Lending**	$	4,882,222,342	100.00

Securities Lending Holdings

		Cost
Repurchase Agreements	$	141,322,733
Banker's Acceptances		
Commercial paper		
Total Securities Lending		141,322,733

Total Investments & Certificates of Deposit $ 5,023,545,075

Policy Limitations

The policy limitations include investment of cash collateral by a securities lending agent calculated as percentages of the portfolio holdings Total Excluding Securities Lending.*

Size Limitations	Holdings	Percentage of Portfolio	Policy Limitations Percentage
Certificates of Deposit	130,550,000	2.67	10%
Bankers Acceptances (BA)	....	0.00	20%
Commercial Paper (CP)	....	0.00	25%
Securities With Higher Volatility	....	0.00	10%
Repos Beyond 30 days	....	0.00	30%
Aggregate BA & CP Holdings	....	0.00	35%

Leverage (30% Total Limit)		
Securities on Loan (dollars out on loan)	$................................	
Reverse Repos	....	
Total Leverage	$................................	0.00%

Maturity Limitations	Currently	Policy Limitations
Portfolio Average Life	31 days	90 days
Maximum Maturity	365 days	397 days
Maximum Maturity of Repo	27 days	180 days
Maximum Maturity of Reverse Repo	0 day(s)	90 days
Average Life of Reinvestment of Cash by Lending Agent	1 day(s)	14 days

Policy Limitations (Continued)

Repo Limits Per Dealer	**September 30, 2002**	**Total Repo Percentage (20% limit)**	**Term Repo Percentage (10% limit)**	**Projected Redemptions 10/1/02**	**Projected Position 10/1/02**
ABN AMRO Inc.	$................................	0%	0%		....
Banc of America Securities LLC	225,000,000	5%	0%	225,000,000	....
Bank of New York	....	0%	0%		....
Barclays Capital Markets	....	0%	0%		....
Bear Stearns & Co.	400,000,000	8%	8%		400,000,000
CS First Boston	....	0%	0%		....
Chase Manhattan	....	0%	0%		....
Daiwa Securities America Inc.	....	0%	0%		....
Dresdner Securities USA	....	0%	0%		....
Goldman Sachs & Co.	341,322,733	7%	4%	141,322,733	200,000,000
Greenwich Capital Markets Inc.	200,000,000	4%	4%		200,000,000
Lehman Brothers Inc.	262,118,000	5%	4%	62,118,000	200,000,000
Merrill Lynch & Co., Inc.	298,734,000	6%	0%	298,734,000	....
Mizuho Securities USA Inc.	....	0%	0%		....
Morgan Stanley	200,000,000	4%	4%		200,000,000
Nesbitt Burns	....	0%	0%		....
Nomura Securities Intl Incorporated	....	0%	0%		....
Paribas Corporation	....	0%	0%		....
Prudential Securities	....	0%	0%		....
Salomon-Smith Barney	200,000,000	4%	4%		200,000,000
UBS Warburg LLC	....	0%	0%		....
Total	$ 2,127,174,733			727,174,733	1,400,000,000

Issuer Limitations		**Percentage**	**Rating**
** Commercial Paper	**Cost**	**(5% limit)**	**(A1/P1 or Better)**

There was no commercial paper holdings as of 9/30/02.

-

Banker's Acceptances

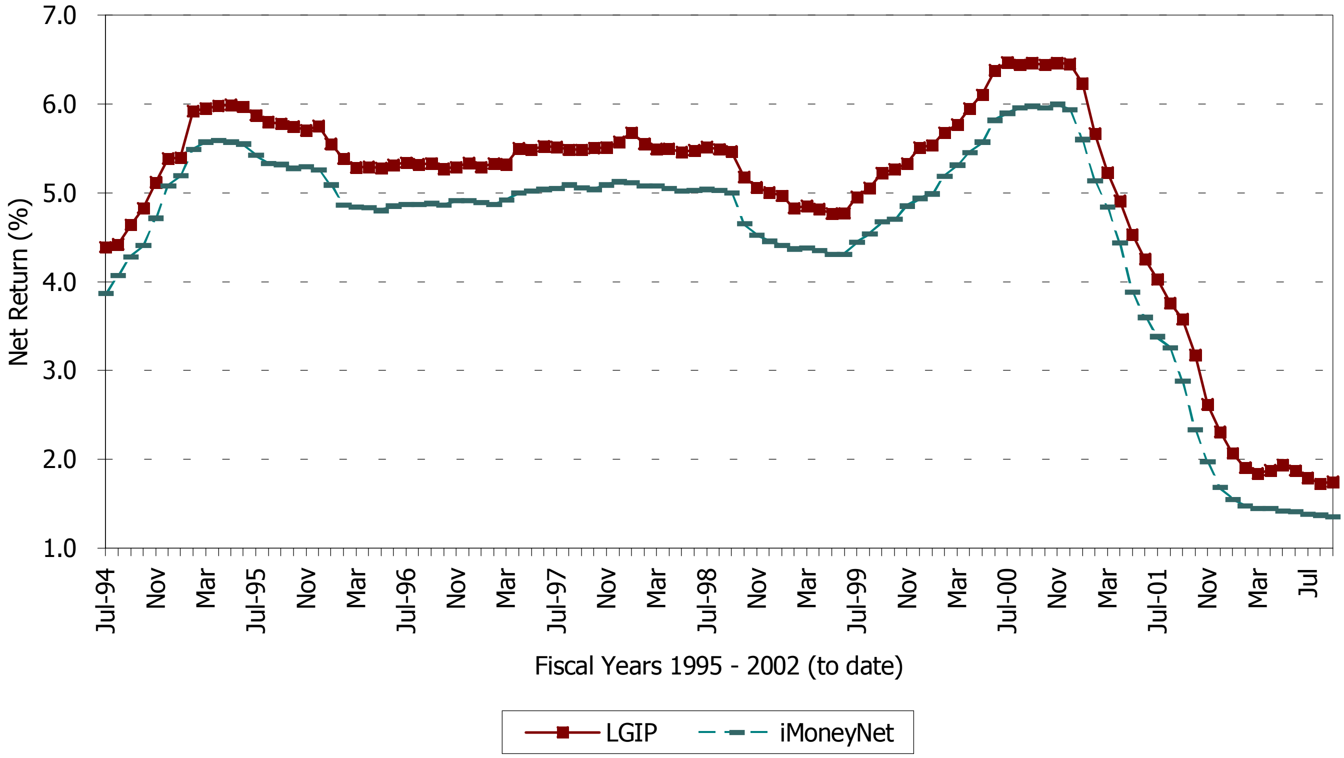
There was no banker's acceptance holdings as of 9/30/02.

-

** **These are the limitations of the formal Investment policy. However, operating guidelines place limits of 3% per issuer.**

LGIP Performance Comparison

iMoneyNet, Inc., Government Only/Institutional Only
versus
Local Government Investment Pool



Net Rate of Return
Fiscal Years 1995 – 2002 (to date)

Average Net Rate of Return of Government Only/Institutional Only Money Market Funds, Money Market Insight, iMoneyNet, Inc., Westborough, MA.

NOTE: Rates are calculated on a 360-day basis.

The above comparison shows how the LGIP has performed relative to its benchmark since July 1994. This benchmark is the iMoneyNet, Inc., Government Only/Institutional Only Money Market Funds, which is comprised of privately managed money market funds similar in composition and investment guidelines to the LGIP.

The LGIP net rate of return has outperformed its benchmark since July 1994 by an average of 47.8 basis points. This translates into the LGIP earning $118.67 million over what the average comparable private money fund would have generated.

Local Government Investment Pool

STATEMENT OF NET ASSETS
September 30, 2002

Assets		
Investments, at Amortized Cost:		
Repurchase Agreements		1,985,852,000
U.S. Agency Coupons		50,646,360
U.S. Agency Discount Notes		2,539,792,722
U.S. Treasury Securities		175,381,260
Total Excluding Securities Lending and Securities Purchased But Not Settled		4,751,672,342
Securities Lending Investments, at amortized cost:		
Repurchase Agreements		141,322,733
Total Investments (Settlement Date Basis)		4,892,995,075
Due from Brokers - Securities Purchased But Not Settled, at Amortized Cost:		
U.S. Agency Discount Notes		547,832,083
Total Investments (Trade Date Basis)		5,440,827,158
Certificates of Deposit		130,550,000
Cash		2,430,188
Interest Receivable		2,087,225
Total Assets		5,575,894,571
Liabilities		
Accrued Expenses		516,696
Obligations under Securities Lending Agreement		141,322,733
Investment Trades Pending Payable		547,832,083
Total Liabilities		689,671,513
Net Assets	$	4,886,223,059
Participant Net Asset Value, Price per Unit	$	1.00
Total Amortized Cost - Settlement Date Basis	$	5,023,545,075

QUARTER AT A GLANCE
July 1, 2002 - September 30, 2002

Total investment purchases:	$	39,555,577,799
Total investment sales:	$	4,632,037,795
Total investment maturities:	$	35,030,527,000
Total net income:	$	22,950,997
Net of realized gains and losses:	$	478,699
Net Portfolio yield (360-day basis):		
	July	1.7935%
	August	1.7246%
	September	1.7478%
Average weighted days to maturity:		31 days

WASHINGTON STATE LOCAL GOVERNMENT INVESTMENT POOL
OFFICE OF THE STATE TREASURER
PO BOX 40200
OLYMPIA WA 98504-0200

RETURN SERVICE REQUESTED

PRSRT STD
U.S. Postage Paid
Olympia WA
Permit No. 179